Nos 54 and 55.

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Supreme Court of the United States.

Appellee (by leave of J. C. Cooper

October Term, 1898.

Filed Oct. 18, 1898.

No. 54.

T. B. MERRILL, AS RECEIVER OF THE FIRST NATIONAL BANK OF PALATKA,

Appellant,

vs.

THE NATIONAL BANK OF JACKSONVILLE,

Appellee.

No. 55.

T. B. MERRILL, AS RECEIVER OF THE FIRST NATIONAL BANK OF PALATKA,

Appellant,

vs.

THE NATIONAL BANK OF JACKSONVILLE,

Appellee.

APPEALS FROM CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

ARGUMENT ON BEHALF OF APPELLEE AS TO APPLICATION OF COLLATERALS.

WILLIAM WORTHINGTON,
GEORGE H. YEAMAN,
Of Counsel for Appellee.

The Evening Post Job Printing House, New York.

Supreme Court of the United States,

OCTOBER TERM, 1898.

T. B. MERRILL, as Receiver of the First National Bank of Palatka, vs. THE NATIONAL BANK OF JACKSONVILLE.	Nos. 54 and 55.

ARGUMENT SUPPORTING DECISIONS BELOW AS TO BASIS FOR DIVIDENDS.

In the case of the Chemical National Bank *v.* David Armstrong, Receiver of the Fidelity National Bank, 16 U. S. Appeals, 465, the Circuit Court of Appeals for the Sixth Circuit had held in November, 1893, that a secured creditor of an insolvent national bank might prove and receive dividends upon the face of his claim as it stood at the time of the declaration of insolvency, without crediting either his collaterals or collections made therefrom after the declaration of insolvency, subject always to the proviso that dividends should cease when therefrom and from collaterals realized the claim had been paid in full.

The same question being presented to the Circuit Court of Appeals for the Fifth Circuit in the cases at bar, that

Court reached the same conclusion, saying, 41 U. S. Appeals, 529:

"From an examination of many of the cases cited and reviewed in Armstrong *v.* Bank, *supra*, as well as a consideration of the reasoning therein, we are compelled to concur with the rule as declared in that case."

The decision of this Court in the case of Western National Bank *v.* Armstrong, 152 U. S., 346, as to the powers of a national bank and its officers to borrow money, led to a remanding of the Fidelity National Bank case for further proofs. The cause coming again before the Court of Appeals, the validity of the claim was sustained and the prior decision as to dividends reaffirmed (54 U. S. Appeals, Nos. 31 and 32, p. 462), and an appeal has been taken by the Receiver of that bank from this last decree which is now pending in this Court, No. 279 upon the docket of this term (General Docket No. 16,849).

We have been counsel for the Chemical National Bank throughout this litigation. After the last decree of the Circuit Court of Appeals, Mr. F. F. Oldham was retained by the Comptroller of the Currency as additional counsel for the Receiver in that case, and later as additional counsel for the Receiver of the Palatka Bank in the cases at bar. Mr. Oldham and Mr. Paige have prepared and filed in the Palatka Bank cases an argument devoted almost exclusively to the single question which is common to those cases and the Fidelity Bank case, viz., the rule as to computation of dividends. Mr. J. C. Cooper, counsel for the appellee, has courteously permitted us to appear as his associates. Naturally our argument will be, in a large measure, a review of and response to that of Messrs. Oldham and Paige, and will be confined to the rule as to computation of dividends.

There are four different rules of distribution which have hitherto met support. These have been accurately stated in the brief of Messrs. Oldham and Paige as follows (Brief, p. 10, italics his).

"RULE 1. The creditor desiring to participate in the fund is required first to exhaust his security and credit the pro-

ceeds on his claim, or to credit its value upon his claim and prove for the balance, it being optional with him to surrender his security and prove for his full claim.

RULE 2. The creditor can *prove* for the full amount, but shall receive *dividends* only on the amount due him *at the time of distribution* of the fund; that is, he is required to credit on his claim, as proved, all sums received from his security, and may receive dividends based only on the balance due him.

RULE 3. The creditor shall be allowed to prove for, and receive dividends upon, the amount due him *at the time of proving*, or sending in his claim to the official liquidator, being required to credit as payments all the sums received from his security prior thereto.

RULE 4. The creditor can prove for, and receive dividends upon, the full amount of his claim, regardless of any sums received from his collateral after the transfer of the assets from the debtor in insolvency, provided that he shall not receive more than the full amount due him."

For convenience we shall call Rule 1 the *bankruptcy rule*, because it had its origin in statutes of bankruptcy; Rule 2 the *partial payment rule*, because it computes the basis for each successive dividend according to the ordinary principle of partial payments; Rule 3 the *Kellock's case rule*, because it was first announced in that case, L. R., 3 Ch., 769; and Rule 4 the *equity rule*, because it has been the rule adopted by courts of equity where the matter is not affected by statute, and is still supported by the weight of authority. The statement of Rule 4 as to collections from collateral "after the transfer of the assets" from the insolvent debtor, must be understood as meaning after the date at which the debtor's power over the assets ceases, and they become impressed with the trust for creditors. In legal effect the two statements are, of course, equivalent, as the transfer when made has relation to the other date, if that be precedent. We mention the matter, however, so that there may be no misapprehension as to the ground upon which we accept the statement of the rule as correct; for if contention were made that the time to be regarded as the actual transfer as distinguished from the period to which it relates, we should state the rule differently.

Before proceeding farther with the discussion, it is

proper that we should call attention to the fact that the reason running through the whole of the brief for appellant, as to why the first, second and third rules should be preferred to the fourth, is that were it not for the pledge, the collateral security would have gone to enhance and increase the assets of the insolvent bank; and practically it admits that if this was not the case, if the insolvent bank had no beneficial interest in the property pledged, then no reason would exist why the creditor should be forced to exhaust the collateral, or apply collections from it, to the exoneration of the assets passing under the assignment; in other words, that in such cases, the fourth rule, as stated by counsel for appellant, is the proper rule to be applied. We mention this because the collections made by the Chemical National Bank after the insolvency of the Fidelity National Bank, were made almost altogether from negotiable paper *to which the Fidelity National Bank had no title;* and much of the collateral still on hand is of the same character. As the cases at bar do not present, as we understand, facts of that nature, but assume that the collateral was, when pledged, owned by the insolvent bank, our argument, like the brief for appellant, will be confined to such a state of facts.

The argument under review correctly says that the decree below in the cases at bar was based upon the fourth rule; but counsel are clearly in error, it seems to us, in contending that the first rule includes the second, and the second rule includes the third, so that these three rules are to be marshaled upon one side as mutually supporting each other, and as all, with the authorities maintaining them, opposed to the fourth. Before it can be stated that one of these is the greater and includes another as the less, we must be sure that the same qualities are being measured. We must look, in other words, at the principles underlying the rules, and see how far they are identical; and must analyze them, before we marshal them for comparison.

On examining these rules, we notice one feature common to the first, third and fourth, and absent in the second, viz., that while in the second the basis for a dividend is asertained at the time the dividend is to be declared, in

each of the others it is ascertained at a prior time. This is not an accidental difference, but an essential one, going to the very ground for the existence of the rule. The basis for dividends represents the quantitative right of the creditor in the funds to be distributed; and a rule which fixes this right at the time of distribution and changes its proportion with each distribution, differs generically from one which fixes it unchangeably at some prior time. This changeable feature exists in the second rule, and is lacking in each of the others. Under the second rule a computation is made as to the balance due each creditor upon his claim at the time of distribution, crediting him with all interest theretofore accrued, and charging him with all payments theretofore made, upon the ordinary rule of partial payments; thus the ratio of the amounts received by the creditors will vary with each dividend according as their rates of interest, and their collections from sources other than the trust funds, may vary. There is no such variation under any of the other rules; in each the amount in which the creditor's claim is first allowed remains thereafter without change, the basis upon which his dividends are computed. No interest is allowed him after the period as of which the amount due him is proved until the face of all claims as they stood at that time shall have been paid; nor is his proportionate interest varied while anything is due him upon the face of his claim by credits made thereon from sources other than the general trust funds. The ratio of each creditor having a proved claim with every other continues unaltered so long as the fund is unable to pay the face of the claim as proved.

Not only do rules 1, 3 and 4 differ from rule 2 in the particulars just mentioned, but they agree with each other in the theory upon which the creditor's interest in the trust fund is determined. That theory is to ascertain the amount due him at the time at which his interest in the trust fund becomes vested. Indeed this is but another mode of stating what we have already said. For the essence of rule 2 is that the creditor has no vested interest in the trust fund, but simply a right to share in distributions made from that fund accord-

ing to the amount which may be due him at the time of distribution; while the other rules all depend upon the principle that the creditor acquires a vested interest in the trust fund by the proof of his claim, and differ only as to the date as of which this vested interest takes effect, and the terms upon which the interest shall be allowed to vest at all.

The bankruptcy rule (Rule 1), is in its origin a creature of statute. For reasons as to which it is unnecessary to inquire, the law maker declared that the creditor of a bankrupt should not have coexisting two claims upon the bankrupt's assets. Before permitting him to acquire a vested claim under the bankruptcy proceedings, they compelled him to exhaust any other claim he might have in assets which, but for such claim, would fall within the domain of those proceedings, or to release his other claim. In other words, they compelled him to exhaust or abandon one vested claim before realizing upon another. When, however, he had complied with these terms and had exhausted or abandoned his prior claim, his claim under the bankruptcy was fixed as to amount as of the date of the adjudication in bankruptcy, and could not be increased by interest thereafter accruing. By the proof and allowance of his claim he acquired a vested interest in the general assets of the bankrupt which, for the amounts so allowed, remained the basis for his dividends.

The equity rule (Rule 4), grew up independent of stattute, and has been developed by courts of chancery upon considerations of equity. One of those considerations is that a trust for the benefit of all creditors, whether created by voluntary act or by the rules of courts of equity, is just what it says—a trust for all creditors. From this follows another principle, that no creditor could equitably be compelled, as a condition for participating in this trust, to give up any other vested right which he held. It had long been a rule of equity that a creditor having a lien upon two funds should not be permitted to exhaust one of them to the prejudice of another creditor having a junior lien upon the fund so exhausted; but this rule was always subject to the modification that

the court of equity would not restrain the senior creditor in such a manner as to prejudice or endanger him in the collection of his whole debt; *they will do nothing which will diminish the amount collectible by him by virtue of all the securities he may hold.* Hence finding that he is a creditor, he is to be treated as such for the amount of the debt due him, and this although he may have specific security for that debt, for any other course would take away from him a part of what he already has. When a trust comes into the hands of a court of equity, the rights of all persons interested in the trust relate back to its creation. If it be a fund to be distributed, it should be distributed at once. Delay may necessarily ensue, either because the fund is not in such form as to be capable of immediate distribution, or because the distributees have not yet been fully ascertained. But these are mere incidents of administration; and as in equity that which is to be done according to a rule already fixed is regarded as done, so the distribution, when it is made, is to be made upon the same theory that would have been adopted had the trust been immediately and completely administered. In other words, the creditors and the amounts due them are to be ascertained as of the day when the trust was declared in their favor; and in the absence of direction to the contrary in the instrument creating the trust, or rules of law out of which it develops, this day will be the same day for all creditors.

The Kellock's case rule (Rule 3) differs from the equity rule only in the fact that it considers the creditor's interest in the general fund to be distributed, as vesting not at the inception of the trust, but at some later date, generally the date of proving his claim before the trustees. Till that time he is not regarded as a beneficiary under the trust; and when, by proving his claim, he manifests his election to become a beneficiary, this does not relate back to the inception of the trust, but takes effect only from the time of manifestation. It is true that this doctrine was not put forth by the judges announcing the opinions in Kellock's case (L. R., 3 Ch., 769). They rested their conclusions upon statutes and rules of court having the force of statutes, which, through the generality of the

reference, we have been unable to identify. In comparatively short time the rule promulgated in that case was changed by statute, which adopted the bankruptcy rule; so that the subject did not receive the same development in England, and examination into the logical foundations upon which the rule must rest, that it otherwise would have had. So far as England is concerned, while the rule continued there in force, it must be regarded, as stated by Judge Taft, of the Circuit Court of Appeals for the Sixth Circuit, as "judge-made" law. But study of the rule and of the principles of law upon which it must rest logically leads to the conclusion just stated, and no other. And it is expressly upon this ground that the Supreme Court of Illinois, in Levy *v.* Chicago National Bank, 158 Ill., 88; 30 L. R. A., 380, followed the rule in Kellock's case in preference to the equity rule, as declared by Judge Taft in the Fidelity Bank case. The Illinois Court says:

"But, under recent decisions of this Court, construing the assignment act of this State, it cannot be said that each creditor acquires a fixed, equitable ownership in the assigned estate at the time of the assignment." Then, after referring to sundry decisions and statutory provisions, they continue: "This being so, each creditor does not have a fixed ownership in the assigned estate at the date of the assignment; and the reason for fixing upon the amount of the claim held by him at that date as the basis for distribution of dividends is without force in this State, however it may be elsewhere. The provisions of the assignment act would seem to lead to the conclusion that the revocable interest of each creditor in the assigned estate only vests in him when he signifies his assent to the assignment by filing his claim with the assignee."

"As his interest in the estate cannot be said to accrue until he does so file his claim, it is the amount of his claim at that date which should be taken as the basis of representation in future dividends irrespective of collections from collateral securities after that date."

So far, therefore, from being true, as stated in brief for appellant (p. 11) that as to the argument of this case "the authorities divide themselves into those that favor the fourth rule and those that oppose it," they divide themselves into those that favor the second rule and those that oppose it. Every case which decides in favor of either the

first, the third or the fourth rule rests upon grounds which are radically inconsistent with the second rule. Under the second rule, the creditor has no vested ownership at all, but simply an interest varying in amount and to be computed afresh every time a dividend is made. Under each of the other rules he has an ownership which is vested long before dividends are paid, and which remains unchanged from the time it becomes vested. A decision which rests upon the basis of a vested interest is manifestly irreconcilable with one which declares there is no vested interest. So, as we have stated, the authorities supporting the second rule stand by themselves. If they find support from pecular expressions in the instruments or statutes creating the trust, they may stand firmly; but if they rest upon general principles applicable to all trusts in insolvent estates, they are opposed in principle to the authorities which support any of the other three rules.

Again, as to the cases supporting the first, third and fourth rules, those that support the third and the fourth rest upon a common principle antagonistic to that contained in those supporting the first, so far these latter rest upon general principles unaffected by statute. For the latter require an election which the former say cannot equitably be demanded.

There is no fundamental difference in principle between the cases supporting the third and those supporting the fourth rule. They agree in declaring that the creditor's right to dividends is to be determined by the amount due him at the time his right to dividends becomes vested, and is not subject to subsequent change; they differ as to the time when it does become vested; but this is an accidental difference except in cases, should such be found, where the language creating the right is identical in two jurisdictions but the decisions thereon different.

We submit that the true solution of this much vexed question is found in the reasoning of the Circuit Court of Appeals in the Chemical National Bank case and also in the Remington case (121 N. Y., 328, hereafter cited), to the effect that "*the contractual relations of the debtor and his creditor remain unchanged although insolvency*

has brought the general estate of the debtor within the jurisdiction of a court of equity for administration and settlement."

Any other rule would result in *impairing the obligation of contracts.*

It may be conceded for argument's sake that in the enactment of a general bankruptcy law Congress may prescribe a mode of administering the assets of an insolvent in such fashion as would result in impairing the obligation of contracts. That is because the power to pass a uniform bankruptcy law is given by the Constitution, and such laws, as they then existed, and were understood did have such effect. The opinion has been further expressed, but we believe that it has never been distinctly held, that outside of a bankruptcy law Congress may enact laws that would impair the obligation of contracts upon the theory that only the States are expressly prohibited from enacting such legislation, and that there is no similar inhibition upon Congress. The answer to this is that Congress has no power except such as is in terms conferred and such as may be necessary to carry into effect the powers conferred, and certainly neither a power to impair contracts nor a necessity for doing it, in order to carry into effect any granted power, can be found in the Constitution. But it is immaterial to discuss that question. Congress has done no such thing in the National Bank legislation.

When a lender receives from the borrower the deposit of collaterals pledged as security, there is established a contractual relation between them. The borrower agrees to repay the money, and to that extent the lender becomes interested in the whole of the borrower's assets, to the extent necessary to pay the debt. He has also become specifically interested in the collateral pledged as security. Indeed, he has become the legal holder thereof and the debtor, the pledgor, has no other interest in the collateral than the trust reposed in the pledgee to account for any surplus that may remain after the payment of the debt.

When a statute prescribed that the secured creditor, in order to prove for the whole of his debt in bankruptcy,

must surrender his security, *or* first realize on it and prove only for the balance, it did to that extent impair the obligation of a contract existing between the creditor and the debtor. Conceding that it was competent for Congress to do this in the form of a bankruptcy law for the reason which has generally been assigned in support of such legislation, yet it is a statutory fact that does not exist in the case at bar, and, it is submitted, could not have been constitutionally made a part of the legislation of Congress governing the administration of insolvent national banks.

And even if Congress might have done so, yet, not having done it in terms, a construction or application of the national bank legislation that would result in the impairment of contractual rights should be carefully avoided.

We are not contending that the constitutional inhibition was aimed at judicial tribunals. That would have been *brutum fulmen.* Courts are vested with power to prevent others from impairing the obligation of contracts, and have always shown great solicitude that their own judgments should not do so.

There being no statute requiring it in this case, we submit that any judgment that interferes with contractual relations comes within the reason for the prohibition.

The bankruptcy rule converts what on its face gives the secured creditor an equal right, into a preference against him, and in effect takes away a right which he already had, which a court of equity never willingly does unless required by statute

Faulty Illustrations.

At page 12 of the brief of Messrs. Oldham and Paige it is stated: "The same is true if instead of a one thousand dollar bond, the debtor tenders one thousand dollars in money, for money can be specifically deposited as security. If the fourth rule is sound, the creditor is wise in refusing to accept it as *payment.*" The fallacy of this reasoning is in assuming a case so extreme that it never arises. No debtor ever deposits money as collateral security for his own obligation. In a few rare cases it may

have been done by a *third party* as guarantor, presenting a fact and a question not involved in this record, but when a debtor "tenders" money and the creditor receives it, the Court would probably always hold it to be a payment.

Further, it is not so clear that in such case the creditor would gain an advantage by taking the money as security. If he did so, he must hold it dead; and in many cases the loss of interest upon his collateral would more than countervail the increase of dividends he would get by treating the money as security instead of payment. If the illustration applies only to money tendered before the trust for general creditors arises, then the debtor can lawfully make no such tender thereafter, and any conversion which the creditor may make of his collateral thereafter is as between himself and his debtor treated as payment; as we have stated before, this is the effect of the decree appealed from in providing that dividends shall cease when, from collateral and dividends, the claim is paid in full.

Again, on same page: "Suppose that C, in failing circumstances, borrows of A $1,000, giving him collateral security of the value of $500, and borrows of B $1,000 without security. Here A increases the assets soon to be conveyed to a trustee by $500, B increases them by $1,000. If C's trustee is able to pay 50 cents on the dollar, A will receive payment in full and B will receive only $500. If, by misfortune or otherwise, the assets had been entirely lost, by such loss A would lose $500 while B would lose $1,000. B's risk in such assets is twice as great as A's."

The fallacy of this reasoning is manifest. It assumes that all of the money borrowed both from A and from B, or the value of it in the form of property, would pass to the assignee for the benefit of creditors. Such is notoriously not the case, and the example overlooks the *contractual relations* of the parties, and the right that lenders have to demand security when they loan, and overlooks the favor with which the law always regards diligent creditors, and the desire courts have to give to them the fruits of their diligence and caution, either in promptly enforcing collections or in taking

security when the money was loaned. In other words, the example given only proves what is true both in morals and in law, that he who trusts most risks most.

Another defect in the illustration is that it overlooks that both A and B have, at the time they make their loans, the security of the promise of the debtor backed by all his assets. The argument would, by retroactive effect, deprive A of one-half of his security. It is not the agreement of the parties or the practical effect that one-half of A's claim has full special security; on the contrary, their agreement is that every dollar of his claim has half special security. The argument splits A's demand in two, a thing which the law neither does nor permits one party to do without the consent of the other.

Touching the argument at page 15 of the brief, we submit that it is all met by the elemental proposition that collaterals pledged for the security of a debt become the property of the pledgee. The legal title is vested in him. He can sue in his own name. It is true that he is a trustee for the pledgor as to any surplus that may be received or collected, over and above the debt secured. For such surplus only he must account to the pledgor, or, if the pledgor has become insolvent, to his assignee or receiver. And, while the pledgee is thus vested with the legal title to the thing pledged, he is also the legal owner of the debt due him from the pledgor, and both rights must be maintained in their fulness, else his rights have been impaired.

Moreover, if a receiver or assignee conceives collaterals pledged for the debt of an insolvent are of value greater than the amount of the debt, he can redeem them, just as the pledgor could have done, by payment of the debt, and thus become not merely subrogated, but make himself the actual owner of the collaterals, without relying on the trust duty of the pledgee to return the surplus. This right to redeem by payment meets all the needs, both legal and equitable, of the situation, without disturbing contractual relations previously established.

Another defective illustration is found at page 16 of the brief. "If A owes B $1,000 not due, and B receives $900 of A's money applicable to the payment of the $1,000, it

must be presumed that they did not intend that B should hold the $900 and still continue to draw interest upon the $1,000." We fail to see how this imagined case illustrates anything. If the $900 was a *payment before insolvency*, it would have reduced the debt to $100 and the creditor could prove for only $100. But if the $900 was deposited in the form of some collateral security, then under rule 4 B would get dividends on his $1,000 without regard to his collateral security, and, if a surplus were produced out of his collaterals, that surplus would belong to the Receiver as successor to A.

At page 19 of the brief, the learned counsel say: "Now, while it is not contended by the advocates for the collaterally secured creditor, that if any collateral is *in fact* collected *before insolvency*, it should not be deducted from his provable claim, yet no consideration has been given to the principle that equity considers that as done which ought to be done. *If it is the debtor's duty to pay when the debt is due, and the creditor's duty to apply the proceeds on his claim*, no reason is apparent why equity should not require these duties to be performed, if other general creditors will suffer from their non performance." (Italics ours.) The infirmity of this argument is quite plain.

It is an extension of the rule that equity will regard as done what ought to have been done, not heretofore familiar to the bench and bar. Because the debtor ought to have paid, but did not, and because the collaterals ought to have been paid, but were not, then equity will consider that done which ought to have been done, although not done. Only a little extension of the reasoning would cut the creditor out entirely. Thus: *The creditor ought to have been paid before the debtor became insolvent, therefore the creditor has no claim at all when insolvency supervenes; upon the ground that equity considered that as done which ought to have been done.*

By giving the secured creditor all the rights of security he has in both funds, general creditors have not suffered by the non-performance of the debtor, or non-performance of the obligors in the pledged collaterals. They may suffer in the sense of having trusted the wrong person, and they

may ultimately suffer in the sense of not being fully paid, thus suffering by their own act in not obtaining security; but they suffer no legal wrong, nor do they suffer any moral wrong. They have acted with their eyes open. They suffer no inequality or inequity. They only suffer the results of loaning money or giving credit without adequate security, while another creditor is saved that suffering by having taken security. The secured creditor has done no legal or moral wrong to those who trusted indiscretely or blindly.

The true application of the rule would be that equity regards the trust fund as distributed upon the day the trust fund was created, because that is the thing which ought to have been done and would have been done if the fund were then in condition for division, and if the shares of its participants had been duly ascertained. The delays of the law in converting the assets into distributable form, and ascertaining the participants and their respective proportions, should not work so as to change their rights.

The decisions of this Court upon the National Banking Act, require the affirmance of the decree appealed from as a necessary corollary

The sections of the National Banking Act to be considered are U. S. Revised Statutes, Secs. 5234, 5235, 5236, 5242, and Sec. 1 of the Act of June 30, 1876, 19 Stat. at Large, 63, supplement to R. S., First Edition, p. 216, and Second Edition, p. 107.

Sec. 5234 and the supplementary act of 1876, authorize the Comptroller of the Currency to appoint a receiver to close up the affairs of a national banking association when it has refused to redeem its circulating notes when presented for payment; or has been dissolved and its charter forfeited; or has allowed a judgment against it to remain unpaid for thirty days; or whenever the Comptroller shall have become satisfied of its insolvency, after examining its affairs. Such Receiver is to take possession of its books and effects, liquidate its assets, and pay the money so made to the Treasurer of the United States.

Sec. 5235 requires the Comptroller, after appointing such Receiver, to give notice by newspaper advertisement, for

three consecutive months, "calling on all persons who may have claims against such association to present the same, and to make legal proof thereof."

Sec. 5242 makes transfers of its property by a national banking association after the commission of an act of insolvency, or in contemplation thereof, to prevent distribution of its assets in the manner provided by Chapter 4, Title LXII. Rev. Stat., or with a view to preferring any creditor, except in payment of its circulating notes, null and void.

Sec. 5236 reads as follows:

"From time to time, after full provision has first been made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction, or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the share-holders of such association, or their legal representatives, in proportion to the stock by them respectively held."

It has been settled that these provisions create a trust in favor of creditors of an insolvent bank, and that this trust has its inception not in the appointment of the Receiver, but in the commission of the act of insolvency which led to that appointment. By that act the lien of the creditors upon the assets of the bank, as they then stood, is fixed. All rights, legal or equitable, which then existed, other than those created by preference forbidden by Sec. 5242, are preserved; and no additional right can thereafter be created either by voluntary or involuntary proceeding.

National Bank *v.* Colby, 21 Wall., 609.
Scott *v.* Armstrong, 146 U. S., 499.

In administering this trust the holders of the circulating notes clearly have a first lien; their notes must first be paid in full, and the balance only is available for disposition among other creditors. And this distribution must be

"ratable" on the claims as proved or adjudicated, that is upon one rule or proportion applicable to all alike; and the rule is to be applied to the *claim*, not to the amount due upon it at the time of distribution.

As the rule must be uniform in its application to all claims, it must regard all claims with reference to the same date or point of time. The dividend could not be ratable, that is in the same ratio or proportion, unless the same basis is adopted for all claims, that is, unless they are all estimated as of the same point of time. In discussing the subject with regard to the scope of the decisions generally, and not as affected by the special provisions of the National Banking Act, we have already pointed out uniformity cannot result if the time of the filing or acceptance or adjudication of the proof of claim be selected, as this time may not be the same for any two claims, and puts it in the power either of the creditor to secure a special advantage, or of the liquidator to force a special disadvantage by accelerating or postponing the time of action, as circumstances may dictate.

And in the previous discussion we have pointed out that the partial payment rule is a rule for dividends *upon the amounts due* upon the claims at the time of distribution, and not for equal dividends upon the claims themselves; and we have pointed out its inconvenience.

It follows that the date as of which the claims are to be ascertained is and must be that as of which their rights *inter sese* arise the date of the declaration of the insolvency of the bank. And so this Court has adjudged in White *v.* Knox, 111 U. S., 784.

In that case it appeared that the Miners' National Bank had been put into the hands of a receiver by the Comptroller of the Currency about December 20, 1875. White presented a claim for about $60,000, which the Comptroller refused to allow. White thereupon brought suit to have his claim adjudicated, and on June 23, 1883, recovered judgment for $104,523.72, being the amount of his claim, with interest to the date of the judgment. In the interim the Comptroller had paid other creditors ratable dividends, aggregating sixty-five per cent. on the amounts due them respectively *as of the date when the*

bank failed. When White's claim was adjudicated, the Comptroller calculated the amount due him according to the judgment *as of the date of the failure*, and paid him sixty-five per cent. on that amount. White, admitting that he had received all that was due him on the basis of distribution assumed by the Comptroller, claimed that he was entitled to have his dividends calculated on the face of his judgment, which would give him $21,379.66 more than he had received, and applied for a mandamus to compel the payment to him of that sum. The writ was refused in the Court below, and its judgment was affirmed. We quote from the opinion of Mr. Chief Justice Waite, as follows (italics ours):

Page 786: "Dividends are to be paid to all creditors ratably, that is to say, proportionally. To be proportionate they must be made by some uniform rule. They are to be paid on all claims against the bank previously proved and adjudicated. All creditors are to be treated alike. The claim against the bank, therefore, must necessarily be made the basis or the apportionment."

Page 787: "The business of the bank must stop when insolvency is declared (Rev. Stat., Sec. 5228). No new debt can be made after that. The only claims the Comptroller can recognize in the settlement of the affairs of the bank are those which are shown by proof satisfactory to him, or by the adjudication of a competent court, to have had their origin in something done before the insolvency. It is clearly his duty, therefore, in paying dividends, *to take the value of the claim* AT THAT TIME *as the basis of distribution.*"

It is not without interest to note that the very argument we are now urging—that the date fixed for the computation of interest shows the date at which the creditor's interest in the assets vests—has been applied conversely by the Supreme Court of Pennsylvania in Jamison's Estate, Boyer's Appeal, 163 Pa., 143. It appeared in that case, as in White's case, that a claim had been put into judgment after the assignment, and this judgment, as usual, included interest and costs up to its date. In allowing the claim, however, against the insolvent estate, the auditor, as did the Comptroller in White's case, allowed interest only to the date of the assignment. This was ap-

proved by the Supreme Court, who said that such a rule followed necessarily from the doctrine that creditors became equitable owners of the insolvent estate in the proportions of their debts at the time of the assignment, referring to sundry cases, and added:

"As on the one hand subsequent partial payment through means of outside collaterals does not diminish a creditor's proportionate share of the assets assigned, so on the other an elargement of his claim by judgment including interest or penalties cannot increase such share."

It being settled by National Bank *v.* Colby, 21 Wall., 609, and Scott *v.* Armstrong, 146 U. S., 499, that the creditor's share of the bank's assets, and by White *v.* Knox, 111 U. S., 784, that his basis for dividends cannot be increased by any right arising after the declaration of the bank's insolvency, parity of reasoning requires that he be not affected to his detriment by any such subsequent right. If a new right cannot work to his advantage, neither can it to his injury.

It has never been contended that the giving of collateral without more operates of itself as a payment or satisfaction either of the debt or of any part of it. The debtor who has given collateral security remains a debtor, notwithstanding, to the full amount of the debt; and, as was said in Lewis, Trustee, *v.* United States, 92 U. S., 623, "it is a settled principle of equity that a creditor holding collaterals is not bound to apply them before enforcing his direct remedies against the debtor."

The amount due upon the claim when the insolvency of the bank is declared is not affected by the fact that the claim was secured. And as the basis upon which the creditor is to draw dividends is the amount of his claim at that time, it follows necessarily that, for the purpose of fixing that basis, it matters not what collateral he may have. He cannot be charged with the estimated value of the collateral at that time, and limited to proving for the residue only; for that would be not only compelling him to exhaust his collateral before enforcing his direct remedies against his debtor, but *selling* the collateral to him. He had entered into no contract to buy it; and, in the

absence of such contract, he cannot be made an unwilling purchaser. Moreover, the bank, when its insolvency is declared, has no power to make such a sale; nor can the Receiver, when appointed, make it *nunc pro tunc;* for he has such power only as the statute gives him, and this is not among them. The secured creditor is a creditor for the whole amount due him when the insolvency is declared, just as much as the unsecured creditor, and cannot be subjected to a different rule. The statute furnishes a complete code for the distribution of the effects of an insolvent national bank, and its provisions cannot be departed from (Cook County National Bank *v.* United States, 107 U. S., 445, 448).

It is urged by our opponents that the case just cited itself in some mysterious and recondite way has adjudged the question arising in the case at bar in accordance with his contention. They practically admit that the question was not raised or debated in that case by counsel nor discussed by the Court, and yet they seem to think the decision of the Court has passed upon it. It should be sufficient on that question to quote the terse statement of Mr. Justice Miller, speaking for this Court in Woodruff *v.* Parham (9 Wallace, 123, 138), where he said:

"We take it to be a sound principle, that no proposition of law can be said to be overruled by the Court which was not in the mind of the Court when the decision was made."

No person can give attentive reading to the Cook County Bank case without seeing that the question we have been here debating was not considered as involved. The bill there was filed by the United States and treated as one not to ascertain the rights of the United States, but to enforce a single right as claimed, viz., the right to a preference not merely for circulating notes, but for other indebtedness, or failing this, to apply the security given for circulating notes to the discharge of other indebtedness. The existence of this rights in both aspects having been denied, the Court did not proceed to find, or make provision for finding, what other rights the United States might have, but dismissed the bill absolutely. The

pleading was apparently anomalous; but the Court treated it as construed by the argument; and finding the plaintiff had not the rights claimed, sustained the demurrer and dismissed the bill. The remarks of Mr. Justice Field on page 449, which are quoted on page 46 of our opponent's brief, are evidently directed in the first instance to the action of the Government before the bank fails; in other words, the Court says that with the one exception as to circulating notes the Government deals with the national bank just as any other creditor does; if it takes security and this security is insufficient, it is in no better position than any other creditor having insufficient security. We submit that the cause must indeed be weak which finds it necessary to contort this decision into a declaration that a secured creditor must buy his collateral or exhaust it and prove for the deficiency.

We have thus endeavored to show that in every question which has heretofore arisen as to the relative rights of creditors of an insolvent bank under the National Banking Act, these rights have been determined by this Court as they stood at the time of the declaration of insolvency. We contend that the same rule applies here; that the claim which is to be proved or adjudged is the claim as it stands at the declaration of insolvency; and that it is not to be modified by anything that takes place thereafter. When the insolvency was declared each creditor had a claim in a given amount against the insolvent bank; for this claim the creditor may prove, and on it he may receive, dividends whether he has security or not. The fact of his having security and of his making collections thereupon is one of utter indifference, with the exception that when he has received payment in full, his rights to dividends and his right to retain his securities ceases.

Having expressed our views as to the concordances and differences in these various rules and the principles upon which they rest, we shall next consider the authorities from which the rules have been deduced, and especially those cited in support of the first, second and third rules respectively. It is deemed needless to consider the authorities cited on page 16 of the brief to the effect that a collection made from collateral is to be applied to

the debt thereby secured. Granting the principle, yet the solution of the question here involved is not advanced. It is conceded that when the debt has been paid in full, whether from collaterals or dividends, or both together, the right to receive dividends ceases. The dispute is as to the date when the amount due upon the claim is to be ascertained for the purposes of dividends. If that amount is to be ascertained as of the date when the creditor's interest in the fund becomes vested, as maintained by the first, third and fourth rules, then it matters not from what source credits may subsequently arise to be applied as a payment upon the debt so long as any portion of the debt remains unpaid. It is only in case the second rule is adopted, by which the amount of dividends is to be ascertained as each dividend is declared, that it becomes material to inquire whether money collected from collateral is a payment or is itself but collateral, as being the proceeds of collateral.

Nor is it necessary for us to refer to the authorities cited on page 13 to the proposition that a liability contingent when the trust begins may be proved if the contingency happens before the time for distribution, further than to say that we do not understand this principle to be "well established," but, on the contrary, to be much debated and dependent in its application upon the language of the statute or instrument creating the trust which may confine its benefits to debts accrued or accruing; or by use of general phrases, such as the word "liability," may embrace not merely debts but claims which are contingent and matters which, though neither actual nor contingent debts, yet will, in the ordinary course of events, become such, *e. g.*, the liability of the tenant for future rents.

Cases supporting the equity rule.

On page 40 of the brief it is, in effect, stated that the only cases to be found in which the equity rule was applied to the extent of allowing a creditor "to draw dividends on the full amount of his claim as it existed at the time of insolvency, regardless of payments since received from collaterals before or after time of proof," are those

decided by the Supreme Court of Pennsylvania, and that aside from the Pennsylvania cases and Allen *v.* Danielson, 15 R. I., 481 (which counsel for appellant contend does not support that proposition), neither Court nor counsel in the Fidelity Bank case were able to find authority for the proposition.

They do not mention the cases which were relied upon by Court and counsel in the Fidelity Bank case, and apparently have not examined them; or such an assertion would not have been made.

We have already called attention to West *v.* Bank of Rutland, 19 Vt., 403, which was one of the cases relied upon by both Court and counsel in the Fidelity Bank case; and we may add that the passage which we hereafter call attention to as omitted in the quotation from that case on page 30 of the brief, under review, was quoted in the printed brief of counsel for the Chemical Bank in the Fidelity Bank case.

Court and counsel in that case also referred to People *v.* Remington, 121 N. Y., 328. The statement of facts there shows that the Receivers objected to the claim not only because the creditor had not applied uncollected collateral, but because he had not deducted sums already realized from the collateral. The opinion of the Court, on page 332, states that the question for consideration is whether the claim should be reduced by a deduction from its amount "of the value of the collateral securities, *or of any proceeds thereof*" (italics mine). In the discussion that followed the Court made no distinction between collaterals realized and those still in *statu quo*, evidently because they saw none, or they had stated it as one of the questions for decision whether such distinction could be made. They affirmed the right of a creditor to prove his claim in the sum due him at the time the trust was declared. In the Court below, however, whose decision was affirmed, the question as to whether any real distinction existed between collections from collateral and collateral unrealized was discussed and decided in the negative. In that case the question at bar was fairly and fully presented, argued by eminent counsel, fully discussed by the

Court, all authorities pertinent to the question were considered, and the rule we now contend for was fully and explicitly adopted. The substance of the decision is correctly stated in the syllabus: "The creditors were entitled to prove their claims against the estate without regard to any collaterals they may hold, and to receive dividends for the amounts proved." The passages here referred to were quoted and commented upon in the printed brief filed by counsel for the Chemical National Bank in the Circuit Court of Appeals.

> See also to the same effect, Matter of Ives, 25th Abbot's New Cases, 63; and 54 Hun, 505, 510.

In Morton *v.* Caldwell, 3 Strobh. Ch., 162, another decision relied upon by Court and counsel in the Fidelity Bank case, it appeared that collections had been made from collateral after the insolvency was declared, but before the claim was offered for proof. Chancellor Johnson, in what Judge Taft in the Fidelity Bank called "a most convincing opinion," held that this made no difference, but that the claim was to be taken as it stood at the time the insolvency was declared. Having shown the difference in the amount the defendant would have received if he had presented his claim before collecting on the collateral, and what he would receive under plaintiff's contention, the Chancellor continues (italics his), p. 165:

"Can a rule attended with such consequences, and founded upon no better grounds than the mere contingency of the collateral payments being made *before* or *after* the presentation, be the rule of law? Can that be the rule which puts it in the power of any third party who chances to be surety for a debt, by a partial payment, however capriciously or collusively made, to reduce the amount recoverable from the estate of his deceased principal, to the disappointment and loss of the fair creditor?"

After a most thorough consideration of the subject, and reversing a prior decision of his own in the same case, the Chancellor held, that equity required that the claims of all creditors must be settled as of one and the same date, regardless of what might happen thereafter, and that the

only date which could reasonably be chosen was that when the trust began.

As to Allen *v.* Danielson, 15 R. I., 480, it is true there is no specific statement in the opinion that the collections upon the collateral were before the claim was presented to the assignee for creditors. But the facts, as stated, lead almost inevitably to that conclusion. The Court say:

> "It appears in the case at bar that the assignee has already made two dividends. No part of the first was paid to the secured creditors when it was made, it being then supposed that the mortgaged property would suffice to pay them in full. Before the second dividend the mortgaged property was sold and the proceeds were found to be insufficient, quite a large residue of indebtedness remaining unpaid." The assignee then paid the secured creditors and made up to them the first dividend, based, however, upon the deficiency only. "The assignee now has more assets to be applied; and the creditors who were secured contend that they are entitled to be paid out of said assets so much as is necessary to put them on an equality with the other creditors, on the basis of their claims in full, before any third dividend is made."

After discussing some of the authorities, the Court conclude:

> "Our decision is that the creditors who were secured are entitled to receive out of the funds in the hands of the assignee so much as will put them on a par proportionally with the other creditors, on the basis of their claims as they were when the assignment was made, before any other dividend—provided that what they receive shall not exceed what remains due to them as creditors—if the assignee has so much."

It is reasonably clear, we submit, that the secured creditors did not present their claim until liquidation of their security showed that it was insufficient.

We have said enough to demonstrate the inaccuracy of the claim of counsel for appellant that the rule for which we contend, when applied to collections after insolvency but before proof, has received support only in the State of Pennsylvania. But were this true it would not weaken the argument, or lessen the confidence with which we urged it. The fundamental case in Pennsyl-

vania, as stated by counsel for appellant is Miller's Appeal, 35 Pa. St., 481, decided by Mr. Justice Strong, afterwards of this Court. It is placed upon a principle which makes all cases approving the same principle authority for rule 4, as phrased by counsel for appellant (B., p. 10), whether in those other cases collateral had been realized before proof or not. That principle is that the creditor's interest in the assets vests at the time the trust is declared; proof of his claim afterwards is simply a matter of administrative detail; when proved, the claim relates back to the origin of the trust in all its attributes; and that the claim at the time is the amount that is owing by the insolvent, and which could be collected from him by suit and execution were he solvent. Collaterals are but collateral; the debt stands in its full amount, and they are but security. Hence collaterals existing at the date of the insolvency cannot be deducted, as they could not be were the insolvent solvent. And as the claim is to be taken as of the declaration of the trust, it matters not what collections have been made upon collaterals since that date.

Every case which rejects the bankruptcy rule, and declares that the claim of the creditor against the insolvent estate is the same claim which he would have if the insolvent were solvent; and that the nature of the trust is such as to give him a vested interest, a *quasi* ownership in the trust assets as of same date, necessarily holds that collections from collateral after that date are immaterial. And every case which rejects both the partial payment rule and the bankruptcy rule, and holds that the amount to be proved is not affected by the collaterals for the claim, must, of necessity, hold that the trust creates a vested interest or ownership in the participating creditors. Holding this logically, they must hold farther that the extent and nature of this interest is not affected by collections made from collaterals after the interest vests. So, as stated before in substance, all cases which apply the equity rule, generally including those which apply the rule in Kellock's case, are authorities for the position that collections from collateral, after the creditor's interest in the trust estate vests, are immaterial; they are all opposed to the bankruptcy rule and the partial payment rule;

they differ among themselves, where they do differ, only as to the date when the creditor's interest vests in law.

In considering whether the weight of authority is with or against the partial payment rule or the bankruptcy rule, it is therefore proper to group together all cases which support the equity rule, meaning thereby the rule that a creditor may prove his claim without regard to the collaterals he holds. For they all are radically opposed to the cases which support the partial payment rule, which rest upon the theory that the creditor has no interest by way of ownership in the trust assets, and to the cases supporting the bankruptcy rule, which rests upon the theory that the creditor's interest in the trust assets is not determined by the face of his claim, but by the amount owing him when his collaterals are exhausted or surrendered; and rest upon the contrary principle that the trust has vested an ownership in the creditor in the trust assets, determined by the amount that is owing to him. They differ only as to when this ownership begins. And all those which assert that it begins as of the date of the origin of the trust, and not the mere proof of the claim, support the contention that moneys realized from collaterals, after the origin of the trust, are not to be deducted in ascertaining the amount to be proved, although the facts of the case before the Court may have called for no expression upon that point.

We shall, therefore, group together the remaining cases we desire to cite, sustaining generally the proposition that the creditor's claim is to be taken as it stood at the date of the origin of the trust, without attempting to distinguish those in which collections were made thereafter, but before proof, and those in which the collections were made only after the proof, or in which no collections at all were made. For, for the reasons stated, such a distinction would be a distinction merely, and not a difference.

First, we give the cases that were cited in the opinion of the Circuit Court of Appeals, omitting those we have above mentioned.

Moses *v.* Ranlet, 2 N. H., 488.
Re Bates, 118 Ill., 524.
Findlay *v.* Hosmer, 2 Conn., 350.

Logan *v.* Anderson, 18 B. Mon., 114.
Citizens' Bank of Paris *v.* Patterson, 78 Ky., 291.
Brown *v.* Merchants & Farmers' Nat. Bk., 79 N. C., 244.
Kellogg *v.* Miller, 22 Oregon, 406.
Miller's Estate, 82 Pa., 113.
Graeff's Appeal, 79 Pa., 146.
Patten's Appeal, 45 Pa., 151.
Third Nat. Bk. of Detroit *v.* Haug, 82 Mich., 607.
West *v.* Bank of Rutland, 19 Vt., 403.
Citizens' Bk. *v.* Kendrick, Pettus & Co., 92 Tenn., 437.

And to them we add the following, some of which were cited by counsel to the Circuit Court of Appeals, but not mentioned in their opinion, and others have been published since their opinion was announced.

Greene, Receiver, *v.* Jackson Bk., 18 R. I., 779.
Brough's Estate, 71 Pa., 460.
Jamison's Estate; Boyer's Appeal, 163 Pa., 143.
Winston *v.* Biggs, 117 N. C., 206.
In re Meyer, 78 Wis., 615.

The common principle underlying all of these cases is that a secured creditor, prior to the assignment, is a general creditor as well, that is to say, has a personal claim against his debtor which he can pursue by judgment and execution against all of the assets of his debtor; that the creation of a trust for creditors is for his benefit as well as for all other creditors; that the proportionate interest of each creditor in that trust is determined by the amount due him when the trust is created; and being then vested cannot be reduced by subsequent events. This theory of the nature of the creditor's interest in the trust fund has received application in Pennsylvania, Connecticut and Ohio from another point of view. Those States require the owner of personal property to return it for taxation.

But in each the Supreme Court has held that an assignee for creditors is not the owner of the assigned property within the meaning of the tax law; that he has but the legal title, the equitable interest being in the creditors.

School Directors *v.* Rathvon, 30 Pa. St., 533.
Brooks *v.* Town of Hartford, 51 Conn., 112.
McNeill *v.* Haggerty, 51 Ohio St., 255.

The Connecticut case presented the question as to the assets in the hands of a receiver of a dissolved insolvent corporation. On page 125, the Court having referred to the decree dissolving the corporation, said:

"Since the passing of that decree the creditors have been and now are the beneficiary owners of all of its property. Within the meaning of the statute just cited (referring to the Tax Act) the property *belongs* to them. That it was not paid over to them at once was because they were not known, and because the amount of their claim was not ascertained, and because the property of the corporation was then widely scattered and not in a form in which payment could be made. But their rights, when determined, will be determined as of the date of that decree. When their claims are paid they will be paid as of that date, *nunc pro tunc.*"

The Ohio case was one of an assignment for the benefit of creditors. On page 263 the Court say:

"The effect of the assignment is to devote the property absolutely to the satisfaction of the debts of the assignor, just as they existed at the time of the assignment, subject, necessarily to be depleted by the existence of the trust."

And again on page 267 the Court say:

"While the legal title to the property is in the assignee it is so only for the purpose of facilitating the settlement of the trust. Equitably, the property is vested in the creditors."

Counsel for appellant suggest that though the doctrine for which we contend has been repeatedly asserted by the Courts of Pennsylvania, yet "they have thrice failed to enforce the rigor of its logic." And they

refer to Sweatman's Appeal, 150 Pa., 369; Assigned Estate of Wilhelm, 182 Pa. St., 281, and *In re* Wetzler's Estate, 3 Pa. Supr. Ct., 435). Examination of these cases show they do not justify the comment; in Sweatman's Appeal the Court held in substance that the assignment for creditors was itself a breach of the contract for a lease previously existing. The right of action in favor of the creditor having been created by the assignment, it was not open to the assignee, or any who claimed under him, to say that it was not in existence when the assignment took effect. The very act which brought the assignment into existence gave birth also to the right of action. They were concurrently in existence from the moment the assignment began. The right of action, therefore, was not subsequent to the assignment, and not being subsequent it could not be deprived of its benefits.

Wilhelm's Estate, 182 Pa., 281, is in no way inconsistent with the other Pennsylvania cases, or with the decisions of the Circuit Court of Appeals.

All that the Court decided was that collections from collateral after the date of the assignment must be applied to interest accruing after that date. This is exactly what was adjudged by the Circuit Courts of Appeal when they declared that the payments to the creditor from dividends should cease when, by such payments and his collections from collateral, he had received payment in full.

In re Wetzler's Ertate, 3 Pa. Sup. Ct . 435, did not present a question under a trust for creditors at all, but simply one of marshaling as between specific lienholders. Lemon and Ramsey each held judgments against Wetzler equal in lien upon his real estate. Ramsey issued execution upon his judgment which was levied December 1, 1892, on Wetzler's personalty. Wetzler afterwards assigned for creditors, and the personal property levied on was, by ageeement, sold by the assignee, but its proceeds to be applied upon the execution. These two judgment creditors being the only claimants, and the assets being insufficient to pay them both, the Court held that the proceeds of the personalty should be credited as a payment, and distribution made *pro rata* after such credit of the balance which arose from the real estate. All the rights

worked out had accrued prior to the assignment, and neither party was endeavoring to enforce a lien obtained by virtue of the assignment.

Authorities cited as to partial payment rule.

These are found on pp. 28–29 of appellant's brief, the statement of their contents continuing to page 37.

The first case in this list is West *v.* Bank of Rutland, 19 Vt., 403-410. This is an unfortunate choice as a leader, since the case does not support the Maryland rule, but, upon the contrary, the equitable rule. And there is an accidental and unintentional oversight in the quotation made from that case on page 30 of the brief, equally unfortunate, because two sentences are omitted, one from the body of the passage quoted — without indication of the omission — and another immediately following that passage, which make manifest what we say. As Judge Redfield's opinion in this case is commonly considered a leading one upon the subject in this country, we shall treat the case with more fullness than we shall consider necessary as to the others.

The facts in brief are as follows:

Lovell and others had become surety with the Bank of Rutland for the Village Falls Manufacturing Co., and Fullerton was guarantor as to the sureties. Fullerton received from the Village Falls Co. "a large amount of funds—but not sufficient to pay his liability," as collateral security. Lovell died insolvent. Fullerton deposited with the bank an amount sufficient to pay the debt, so as to make it secure; but this was not applied in payment, because it was desired that proof of claim be made against Lovell's estate by the bank, instead of Fullerton, which was done for its full amount. Thereupon another creditor brought this suit, alleging that the proof was made in the name of the bank for the use of Fullerton, and asking that an account be taken of the collaterals received by Fullerton, and the collections thereon, and the proof of claim revised by crediting such collaterals or collections. Fullerton admitted having realized $5,160.98 on the collateral.

The Court below had dismissed the bill, and on appeal this decree was affirmed, the Court deciding that it had power to revise the allowance of the claim, that it must be treated as if proved in the name of Fullerton, but that notwithstanding that Fullerton had collateral, and that part of this collateral had been converted into money, yet Fullerton might still prove and take a dividend upon his whole debt, unaffected by such collection.

While the report does not state specifically whether the collections were made by Fullerton before or after the proof of claim, yet it seems apparent from the course of the discussion that they were made before.

Turning now to the passage which is partly quoted on page 30 of the brief, the oversight, as we have said, destroying its real meaning, we give the passage as it is found in the report, italicizing the omitted matter:

"It is true, that if the security has been converted into money, and it is between debtor and creditor, it ceases to be collateral and operates directly as payment, so that the debt is thereby reduced and the creditor can only go for the balance. *And if the fund, which is collateral, is such, that the dividend will more than make up the deficiency, then, upon the payment of the whole debt, the creditor must assign.* This was the only remedy at the civil law. In England and in this country, in such case, the Court of Chancery will often times compel the party to apply the funds in his hands and only proceed against the other funds for the balance, and, if the funds are not money, will require them to be reduced to money. *But in no case, where the security is merely collateral, will a court of equity compel its application, merely for the purpose of reducing a dividend, unless the debtor stands in the relation of a co surety.*

This case is not in principle to be distinguished from that of a mortgage security merely, which the party may hold, and still take a dividend upon his whole debt."

It appears clearly enough from this passage, and this impression is confirmed by the residue of the opinion, that when Judge Redfield says money realized from security ceases to be collateral, and operates as payment so that the debt is thereby reduced and the creditor can go only for the balance, he is referring to the transaction merely as it stands between debtor and creditor, as he himself

says in the same sentence. If his meaning were otherwise doubtful, it is shown to a demonstration by the next sentence (the first omitted passage we have italicized); for if in a trust for creditors one was allowed to prove and receive dividends only upon the balance due him after applying collections from his collateral, it is impossible that a dividend apportioned *pro rata* upon this balance should pay the balance, and yet the estate be insolvent. A *pro rata* dividend could not *more than* make up the deficiency if it were calculated upon the deficiency. This first italicized sentence is also necessary to make clear the thought in Judge Redfield's mind when speaking of the civil law remedy. He did not mean, as one would suppose from reading page 30 of our opponent's brief, that applying collections as payment and going for the balance was the only remedy at the civil law, but that paying up the debt and taking an assignment of collateral was that only remedy. The instances to which he alludes, where a court of chancery will compel the exhaustion of funds in the creditor's hands before permitting him to proceed against the debtor's estate are probably those exceptional cases where the funds held by the creditor are in fact the *res rea*, the thing in default, and the debtor's obligation is merely secondary in the nature of a guaranty of sufficiency, not of payment; such as the case of a factor who makes advances on the credit of goods consigned (Balderston *v.* National Rubber Co., 18 R. I., 338; Matter of Atwood & Sons, 3d App. Div., [N. Y.,] 578.) Certainly they are not cases where the debtor has entered into a personal obligation of payment, and furnished security that he will fulfill it, for in the next breath he states that in no such case will equity compel the prior application of collateral. And in 3d Appellate Division the Court distinguishes the case from People *v.* Remington, above cited, by pointing out that in the Remington case there was a debt for which collateral had been pledged, while in the case before the Court the debt "only comes into existence after the sale of the (consigned) property, and then the debt is for the deficiency, and that alone can be proved" (p. 581).

In re Estate of McCune, 76 Mo., 200; Erle *v.* Lane, 22

Colo., 273, and Third National Bank *v.* Lanahan, 66 Md., 461, the statutory requirement was that the distribution should be made "according to the respective amounts" due the creditors. This was held to mean the amounts due at the time of distribution. Thus the Missouri Court says (p. 206):

"Now, the 'amount' of a demand, it is almost superfluous to say, embrace the interest as well as the principal of such demand. Both principal and interest constitute, in the aggregate, the amount or sum total of that demand."

And adds that payments are to be credited as in any case of partial payments.

In the Maryland case the Court said (p. 468):

"The obligation of the trustee to pay does not depend upon the state of the account between the creditor and the assignor at the time of the assignment, but at the time when payment is made."

And in the Colorado case the Court expressly distinguished the decision in the Chemical Bank case and others of that nature, after quoting from them sufficient to show they rest on the theory that the creditor has acquired a vested interest in the assets by saying (p. 277) that the quotation:

"Shows their irrelevancy to the case at bar, since the creditor of the estate of a deceased person has no ownership or vested interest in its assets."

Then they quote the State of Colorado, which provides in terms for a retabulation of the debts of every dividend In this connection, we may refer to Jamison *v.* Adler-Goldman Com. Co., 59 Ark., 548, a case overlooked by our opponent, which takes this same distinction as to lack of vested interest under the provisions of the statute of Arkansas, and for that reason distinguishes, while approving, the cases upholding the equity rule.

The cases of Lowell *v.* French, 54 Vt., 193, and Bank *v.* Alexander, 85 N. C., 352, presented the question whether collections from the estate of an insolvent principal should be credited to reduce the claim against the estate

of an insolvent surety. The Courts held that they should, the North Carolina Court distinguishing the case by the fact of suretyship. In the Vermont case the claims had already been proved against the surety before the payment was received from the principal; but in the North Carolina case the collection had been before proof. The North Carolina case, therefore, should not be grouped among the cases supporting the partial payment rule, but those supporting the Kellock's case rule.

Page 31 of the brief refers to Blumenstiel on Bankruptcy, page 287 *ex parte* Harris, 16 N. B. R., 432 (11 Fed. cases, 606, No. 6109), and *in re* Babcock, 3 Story, 393 (2 Fed. cases, 289, No. 696), as supporting the same contention in administration under the bankruptcy acts. The authorities cited by Blumenstiel at the place mentioned are English, and depend upon the provisions of the English bankruptcy acts. It would carry us too far afield to investigate those. The American cases referred to do not support the contention. Judge Story's opinion in *in re* Babcock is to the contrary; and Judge Lowell's in *ex parte* Harris, was a factor's case like the decision in Rhode Island and New York above referred to.

The feature mentioned that the collection received was from the principal and the dividend to be made was from the surety might of itself, be sufficient reason why we need not concern ourselves with these cases in discussing another where such relations did not exist. But before dismissing them from consideration, we desire to add that even where such relations exist the contrary rule is supported by the weight of authority. Even the Courts of Massachusetts, which have held most faithfully to the bankruptcy rule, have recently refused to apply it in such a case as this; see Roger Williams Nat. Bank *v.* Hall, 160 Mass., 171, where Holmes, *J.*, in a case where it was sought to prove against both maker and endorser of a note, said:

"In view of the modern decisions and the general agreement of opinion, we think it unnecessary to argue elaborately for the right of a creditor who has acquired two contracts binding two distinct estates to insist upon both."

The weight of Philadelphia Warehouse Co. *v.* Anniston Pipe Works, 106 Ala., 357, is materially reduced by the fact that the Court regards the case in 66 Md., 461, as identical in principal with their own decision in Gusdorf & Co. *v.* Ikelheimer & Co., 75 Ala., 153, overlooking the fact that in the latter case there was no trust for general creditors, but a contest between specific lienholders, and the holder of the prior lien had security sufficient to satisfy his claim whichever way the securities were marshaled.

The case of Whittaker *v.* Amwell Nat. Bk., 52 N. J. Eq., 400, should not be classified among the cases supporting the partial payment rule, but among those supporting the bankruptcy rule—it falls there in effect; for while the Judge permits proof before exhausting collaterals, he denies a dividend until that is done.

Thibaudeau *v.* Benning, 20 Canada Sup. Ct., 110, presented questions under, and was decided upon, peculiarities of the provincial law or customs of Quebec. One curious upon the subject should examine not only the report on appeal, cited as above by our opponent, but those in the lower courts (Montreal Law Reports, 2 Superior Ct., 338, and 5 Q. B., 425). Because the case depended upon Quebec law, the Supreme Court of Canada, in Cooper *v.* Molson's Bank, 26 Canada Sup. Ct., 611 (also cited by our opponent's brief, p. 16), when discussing a case of partial payments as between debtor and creditor, and not in an assignment, said it presented questions identical in principle with those in the Thibaudeau case, but was not governed thereby, because that was decided upon the law of Quebec.

In Wheeler *v.* Walton & Whann Co., 72 Fed., 966, Judge Wales did not adopt the partial payment rule, but the Kellock's case rule. As this was all which the creditor in that case contended for, the dispute being only whether that rule or the bankruptcy rule should apply, obviously the decision is no authority for the partial payment rule.

In London & San. F. Bk. *v.* Snell, &c., Co., 83 Fed., 603, Judge Bellinger adopted the partial payment rule not because he approved of it upon principle, for he says that the weight of authority is in favor of the equity rule, but

because the creditor, by its conduct, had estopped itself from asking the benefit of any other rule.

The case of Nebraska *v.* Nebraska Savings Bank, 40 Neb., 342, illustrates how far wrong a court, when once started on the wrong path, can go, and without regard to vested rights. Admitting that the equity rule is supported by the weight of authority, and, therefore, having presumably read the cases supporting it, and having seen that the reason why it was thus supported was that a creditor having a lien upon the two funds, both of which would not pay him in full, could not be compelled to exhaust one and prove for the balance only against the other without curtailing his rights, and further having seen that the rights of all creditors in the common fund were to be adjusted as of the date when those rights accrued, without credit or charge because of new rights arising thereafter, yet the Nebraska court conclude that the equity rule is not as equitable as the bankruptcy rule and then follow neither, but the partial payment rule; and having gone thus far against the weight of authority, they seem to think they have not shorn the secured creditor enough, but that he must even be deprived of the right to manage as he sees fit the security given to him before the assignment and over which he has a sole lien, and should turn that over to the representative of all the creditors to be by him handled and adjusted, reserving only to the secured creditor a lien upon the proceeds. Surely a decision which goes to such extremes is not entitled to claim obedience beyond the jurisdiction in which, by law, it is authoritative.

Wheat *v.* Dingle, 32 S. C., 473, does not seem to have been accepted as authority, even in the State of South Carolina. For, in the case of Ragsdale *v.* Winsboro Bank, 45 S. C., 575, it appears that the Court below had ruled with reference to collaterals in accordance with the equity rule and in conflict with Wheat *v.* Dingle, and that no exceptions were pressed against this ruling, showing the acquiescence of counsel in it. Although in the Winsboro Bank case the Court disclaims an assent to this practical overruling of Wheat *v.* Dingle, and attempts to distinguish that case, yet the result, if the distinction taken be

adhered to, will certainly be peculiar. Wheat *v.* Dingle had held that collateral security furnished by the debtor must be exhausted and the creditor's claim proved only for the balance. In the Winsboro Bank case the Court hold that where both principal and surety are primary and secondary debtors upon an obligation and are insolvent, the holder of that obligation may prove it against the estate of the insolvent surety or secondary debtor, without first crediting as payment any sum he may have received since the origin of that trust from the principal or primary debtor, or his assets in assignment. Follow this process of reasoning one step farther, and supposing each of these cases to be adhered to, contrast the result in three cases of very common occurrence:

1. A borrows $1,000 from X and gives him as collateral security the note of B. A and B both make assignments. Under Wheat *v.* Dingle, X, before receiving dividends from the assignment of A, must give credit for all collections from the asssignment of B.

2. A borrows $1,000 from X and gives him his note therefor, with C as surety. Afterwards A and B both make assignments for creditors. Under Ragsdale *v.* Winsboro Bank, X can prove his claim against B as it stood at the date of B's assignment, without regard to any collections he may subsequently make from A or his assets.

3. A borrows $1,000 from X and gives him therefor his note, with C as surety, and also as collateral the note of B. Afterwards A, B and C all become insolvent, and make assignments for creditors. Under Wheat *v.* Dingle, X, in taking dividends from the assets of A and C, must give credit for all dividends theretofore received from the estate of B; but his dividends from the estate of C are not to be reduced by anything he receives from the estate of A after C's assignment; and conversely, his dividends from the estate of A are not to be reduced because of anything he receives from the estate of C after A's assignment.

In other words, in the last instance both the partial payment rule and the equity rule are to be applied to the

same claim. C is confessedly merely a surety in the transaction specified in case 3; when the time for payment comes the creditor, X, has not merely C's liability as surety, but A's as principal and B's as collateral security. C is not allowed to use in exoneration the receipts from A's liability, but presumptively is allowed to use the receipts of X. Had there been no assignment, X could have pursued A, B and C concurrently, and neither could restrain him without payment in full. By making a subsequent assignment C gives to his assets thus becoming owned by the body of his creditors a right which he himself did not possess, viz., to compel X to pursue B to the exoneration of C's assets.

In other words, an attempt to enforce concurrently the rules laid down in these two cases leads to this result: The assignee for the creditors of a surety may reduce the basis for dividends of the creditor by compelling him first to deduct collections he has received from collateral security given to him by the principal at any time, but may not compel him to deduct receipts he gets after the surety's assignment from the direct security furnished by the obligation of the principal, or the substitute for that direct security which the assignment of the principal creates.

Manifestly the cases are inconsistent; and although Ragsdale *v.* Winsboro Bank attempts to distinguish Wheat *v.* Dingle, yet in effect it overrules it. It is impossible logically, we submit, to draw a distinction between security furnished in the form of bills receivable, or other property, and in the form of the obligation of a third person directly upon the loan. The surety, by signing such paper, becomes primarily liable to the creditor and *pro hac vice* makes his assets a part of the debtor's assets, a position from which he can be relieved only by payment, the surety thus acquiring the right himself to pursue the debtor.

What is an assignment for creditors but giving security to creditors additional to what they already have? When the Supreme Court of South Carolina admit, as they do in Ragsdale *v.* The Winsboro Bank, that not merely the weight of authority, but the weight of reason, requires that a creditor's claim against a person secondarily liable

upon a debt shall be established and receive dividends according to its amount when the trust for the creditors of that estate was created, without regard to collections thereafter made from the principal, necessarily they must hold that this rule applies to the proof of all claims, whether against principals or sureties, persons primarily or secondarily liable.

As to what is said about the partial payment rule on pages 13-14, we trust we have sufficiently demonstrated that this rule cannot co-exist with a vested interest in the creditors relating to a period anterior to the time of distribution. This rule requires the adjustment of the amount due upon the claim every time a dividend is declared, and consequently the allowance of interest up to that time; hence it cannot be applied in trusts where no interest is allowed after the inception of the trust. As Judge Taft said with reference to it in the Fidelity Bank case, 16 U. S. Appeals, 465:

"But the rule cannot be sustained, because its adoption proceeds on the theory that the claim of the creditor in reference to the sequestered assets of the debtor and the debt against the debtor are and continue to be one and the same thing. This is a fundamental error. The amount of the claim as proven is a mere measure of the creditor's right and interest in the fund realized from the assets. The claim as proven is a claim *in rem*, and not *in personam*."

Further, the frequent computations and consequent changes in the proportions payable to each creditor differing with every dividend, are, in themselves, sufficient to cause the rejection of the rule as a practical measure of administration where statute, or practice pre[illegible]ing so long as to have the force of statute, or the ter[illegible] of the trust which is being administered, do not comp[illegible] its adoption.

The merit of the third rule (that in Kellock's case), as compared with the partial payment rule is not merely the lightening of the labor of the liquidating officer, as suggested by appellant's counsel. True, it has that advantage, but that is simply an incident, a resultant detail, and not of the essence. The rule rests, as already stated,

upon a principle radically different; and it is as much in hostility to the partial payment rule as the equity rule is. Its chief merit over the partial payment rule is because it recognizes, as does the equity rule, the fact that the trust has created a vested interest in creditors which cannot be lessened or altered by subsequent events. Its demerit, as compared with the fourth rule as stated (of which it is but a variation), is that under it there is no one fixed time and rule which is applicable to all creditors. Under the Kellock's case rule each creditor selects his own time for initiating his interest in the trust fund; or if he does not select it, then the liquidating officer does; for his ins terest under this rule initates either when his claim is presented to or allowed by the liquidating officer—the time of the former being determined by the creditor, and that of the latter by the officer. The creditor will, therefore, hurry or postpone his time of proof according as his interest may lie; if his claim carries a high rate of interest and has but little security, and that not soon maturing, he will do well to delay; on the other hand, if his rate of interest be low, or his security be apt to be quickly paid, he will do well to hurry. And conversely with the liquidating officer if the time when the creditor's interest vests rest- upon not the presentation but the acceptance or allowance of the claim. Manifestly it is bad policy to adopt, without constraining necessity, a rule permitting interests to be varied by human whim or caprice.

In discussing the equity rule (pp. 14–22), three arguments are stated by which it is supported. To the comment upon the first (pp. 15–19) we respond that it is beside the case. As we have repeatedly said, the equity rule admits that as between debtor and creditor collections from collateral will be considered as payment after an assignment just as much as before, and so the decrees drawn under such rule provide that when the claim is paid, whether from collaterals or dividends, the right to dividends shall cease; but because this is true as between debtor and creditor, it does not follow that it is likewise true with reference to the security given to the creditor for the whole of his debt by an assignment for creditors, or by the equivalent trust of an official receiver-

ship. If each creditor's rights in the trust fund, as compared with his co-creditors, are fixed and established at the creation of that fund, then they cannot be changed by anything that is done afterwards either by the debtor, or a third party, or any one of the creditors, but only by consent of all the creditors. And the enforcing by one creditor of what is merely his right, or the performance by a third party of what is merely his duty, to which a creditor must consent, cannot further establish the consent of that creditor to a change of his relations with his co creditors.

What we have just said is an answer also to the comments made (B., pp. 20–21) upon the second argument, as there stated in favor of the equity rule. The equity rule does not *assume* that the creditor has a lien upon the fund before he proves his claim in the sense in which he uses those words; on the contrary, the cases which adopt the equity rule *decide* that he has such iien. If the question is to be considered as a general one to be determined by the weight of authority, undoubtedly the weight of authority is in favor of the equity rule.

The suggestion that the relative amount of the interest is not determined when the trust is created is not valid. *Id certum est quod certum reddi potest.*

So, too, we have anticipated the response to the answer (on pp. 21–22) to the third argument stated, as adduced in favor of the equity rule. The statement as to the allowance of interest would be more exact if it were said that interest is not allowed against the assets after the date of the insolvency until the claim has been paid in full. This shows it is true that the right of the creditors in the assets is not constantly measured by their claims against the debtor; but it shows further that their right against the assets is measured by their claims against the debtor up to the period of time from which interest is allowed out of the assets; for that establishes their rights *inter sese;* and their rights *inter sese* are the same as their rights against the fund.

As to the case of Holmes *v.* Union Trust Co., 146 Ind., 688, cited in appellant's brief, page 44, it is sufficient to say that the decision of the Court was rested upon the

analogy of their statute which adopts the partial payment rule of distribution in terms, and therefore compelled the decision.

To conclude the reference to the cases cited on pages 28 and 29 as supporting the partial payment rule, we submit that an examination of them will result in striking most from the list, either as not supporting that rule at all, or as depending upon peculiar facts, or as depending upon special provisions of statute preventing the application of the fundamental principle upon which the equity rule rests, viz., the vested interest of the creditor in the trust fund. The few that remain are insufficient to withstand the overwhelming current of authority that where that vested interest does appear it controls in the distribution.

Cases Supporting the Bankruptcy Rule.

Proceeding now to the cases cited on pages 24 and 25 as supporting the bankruptcy rule, we will find that they also need pruning. The Massachusetts cases, it is true, apply the bankruptcy rule, and five of the cases cited come from that State. Yet even there, as already stated, a tendency has recently been shown not to extend that rule beyond previous decisions (see Dickinson *v.* Metaconset Bank, 130 Mass., 132, and Roger Williams Nat. Bank *v.* Hall, 160 Mass., 171). The leading case in Massachusetts is Amory *v.* Francis, 16 Mass., 308. Chief Justice Parker there assumed that the rule in bankruptcy was a rule in chancery as well, and adopted it without considering that thereby one of the most thoroughly established principles in equity was violated, viz., that which declares that a creditor with a superior lien cannot be compelled, by marshalling, to sacrifice any of his advantage. The learned Chief Justice also was mistaken as to the practice of the Court of Chancery in England, as has been since demonstrated by the inquiries made of the Clerks in the Master's office, at the suggestion of Lord Cottenham, and recorded in Mason *v.* Bogg, 2 My. & Cr., 450 451, and from the opinions given in Kellock's case, L. R., 3 Ch., 769. However, the rule adopted in Amory *v.* Francis was shortly after carried into the insolvent statutes of Massachusetts,

and may be considered the settled law of that State. Under these circumstances it is needless to refer to the other Massachusetts cases which have been cited.

In re Frasch, 5 Wash., 344, adopts this Massachusetts rule as the most equitable, and attempts to draw some support from the provisions of the Assignment Act of the State of Washington.

The cases of Creecy *v.* Pearce, 69 N. C., 67, and Moore *v.* Dunn's Admr., 92 N. C., 63, do not reach or rest upon the bankruptcy rule. The contest there was not between creditors, but between a mortgage creditor and a dowress, who attempted to throw the mortgagee upon the personalty in the first instance, where the personal estate was insufficient to pay the debts. The Court required the mortgagee to exhaust first the two-thirds of the real estate free from dower; as to the balance, to prove against the personalty, and for the deficiency, if any, to apply the dower lands. There is nothing from which we can infer that this method of marshalling would not pay the secured creditor in full. Indeed, the inference is to the contrary. So the question as to which was the most equitable, the bankruptcy rule or the equity rule, was not decided. That question did come before the North Carolina Court in Brown *v.* Merchants' Nat Bk., 79 N. C., 244, and Winston *v.* Biggs, 117 N. C., 206, and the equity rule was adopted.

Wurtz *v.* Hart, 13 Iowa, 515, was decided without argument, and apparently without much consideration. Its force is further weakened by the fact that it refers to Dickson *v.* Chorn, 6 Iowa, 19, as controlling, while an examination of the latter case shows that it is no precedent for the other. However, as the subject has been again reviewed during this year by the Supreme Court of Iowa, in Doolittle *v.* Smith, 73 N. W., 867 (cited on p. 29 of Brief), and the Court there approve of the partial payment rule, apparently conceiving it to be the same in principle as the bankruptcy rule, we may concede that that State also is opposed to the adoption of the equity rule. But with reference to this last decision, it should be observed that while the Court rest their conclusion upon the old equitable principle that he who has two securities shall so

enforce his rights as not to injure him who has but one, they neglect its limitation that the creditor having the senior liens cannot be compelled to do injury to himself, or to take a course which will diminish what he would receive had there been no junior lien.

Willis *v.* Holland, decided in 1896 by the Texas Court of Civil Appeals, 36 S. W., 329, does not touch the question under consideration, because there the creditor having the senior lien was to be paid in full at all events, so he could not be injured by the manner in which his securities were marshalled.

In Bell *v.* Fleming's Executor, 1 Beasley, 13, the question for decision was merely whether a secured creditor who proved against the general fund, by that very act surrendered any other security he might have. This question the Chancellor answered in the negative. What was said as to the amount in which the secured creditor could prove and the dividends he should receive was purely *obiter.*

So, too, the question was not presented in Fields *v.* Wheatley's Creditors, 1 Snead., 351, and Winton *v.* Eldridge, 3 Head., 361. In the former case the Bank of Tennessee claimed that as it stood for the State of Tennessee, it was entitled to a preferential lien upon the general assets; while the creditors claimed that it could receive nothing from the general assets until they had received as much therefrom as the bank had obtained from other securities it held. In the latter case the claim of the general creditors only was presented. These claims were overruled, and in the first case the bank, and in the second case the secured creditor, was allowed to prove *pro rata* after exhausting the special security; but upon this last point there was no discussion or contention, and consequently the cases are not authority with reference to it. However, the Supreme Court of Tennessee has had occasion to consider the question, and in Citizens' Bk. v. Kendrick, Pettus & Co., 92 Tenn., 437, they adopted the equity rule.

In Nat. Union Bk. *v.* Nat. Mechanics' Bk., 80 Md., 371, the Court considered the power to compel the application of collaterals before proof against general assets, as fol-

lowing as a corollary from the power to compel the application of collections from those collaterials before dividends as a payment *pro tanto* (as held in Third Nat. Bk. *v.* Lanahan, 66 Md., 461). The former case, like the latter, rests upon what seems to have been a long established practice in Maryland requiring securities or collections therefrom to be credited when proof is made. They throw the practice of the State of Maryland into the scales against us, but not, we submit, upon any principles of general application.

The decisions from Kansas, the American Nat. Bk. *v.* Branch, 57 Kas., 27, and The Security Investment Co. *v.* Richmond Nat. Bk., 58 Kas., 414, were probably influenced by the peculiar facts, and illustrate the old adage that hard cases make bad law. The insolvent was a Kansas investment company which had guaranteed the payment of principal and interest on farm loans negotiated by it; and the Court held that the security for the loans must be exhausted before the assets of the insolvent could be pursued. The cases are but little argued, and contain no reference to the very numerous authorities to the contrary if the guaranty be considered an absolute one, and not merely a guaranty of collectibility.

Thus we find that the bankruptcy rule has been adopted by the Courts of Massachusetts, Maryland (if we consider 80 Md., 371, just mentioned as an adoption there), Iowa and Kansas; and in those States only, so far as the appellant has been able to produce authority. And we find further that the cases where it was applied in Kansas were cases where it would have been denied application in Massachusetts, and that the ruling in Maryland was influenced by a local practice of a century's duration.

Cases Supporting the Kellock's Case Rule.

These will be found on page 37 of brief for appellant. The English, Irish and Canadian cases cited may be dismissed with the remark that they all follow Kellock's case as binding authority without discussion of the principles leading to the decision there announced. As

before stated, we have not been able to find the statutes and rules of Court upon which the Judges of the Court of Appeals, who sat in Kellock's case, based their conclusion that while collections of collateral after proof of claim were not to be applied in reduction of the claim as admitted to proof, collections from collaterals before proof were to be so applied. But we have stated that a real and substantial reason for this distinction is that which has been taken by the Supreme Court of Illinois in Levy *v.* Chicago Nat. Bk., 158 Ill., 88, viz., that the creditor acquires an interest in the assets only by the proof of his claim. Placed upon this ground the decisions accord in perfect harmony with those which support the equity rule; for they all rest upon the same principle that the creditor's rights to dividends is to be based upon the amount of his claim at the time his interest in the assets vests under the statute or deed of trust, or rule of law under which they are to be administered. These cases, therefore, are not at war with the main principle adjudged by the Circuit Courts of Appeal in the Palatka and the Fidelity Bank cases; nor are they at war with the conclusions there reached as to when the creditor's interest in the assets became vested, as the Circuit Courts of Appeal were considering the National Banking Act, while the other courts were considering statutes of other sovereignties, phrased in other terms.

What we have said *supra* with reference to the case of Levy *v.* the Chicago Nat. Bk. relieve us from giving further consideration to it here, and from referring to the earlier case of Furness *v.* Union Nat. Bk., 147 Ill., 570, further than to say that the Levy case is an elaboration of the argument contained in the Furness case, and the decision of some matters which were there but *dicta.*

In Sohier *v.* Loring, 6 Cushing, 537, the Supreme Court of Massachusetts again followed the rulings which had been made by the English courts in administering their bankruptcy acts, to the effect that the amount for which a creditor could prove was the amount which was due him at the time his proof was made, and was not affected, so far as dividends were concerned, by collections he

might thereafter receive from other persons liable upon the same indebtedness. They thus reach the same result that was reached in Kellock's case and in the Illinois cases, but give no reason for it further than that they "adopt the rule applied in bankruptcy" (p. 548). The only other case cited by our opponents under this head is *In re* Meyer, 78 Wis., 615 This was a case where the holder of an overdue note sought to prove it against the endorser, who had made an assignment after the note matured; the maker also was insolvent. The assignee of the endorser sought to compel in effect the application of the partial payment rule, and to require the holder, before receiving dividends from the estate of the endorser, to reduce his claim by any dividends he might in the future receive from the estate of the maker, and dividends paid only upon the balance. The Court rejected this contention as opposed to the very decided preponderance of authority. They do not decide that the creditor must apply as payment any sum which he had received from other parties to the note after the insolvency, but prior to proving his claim, because no such question was presented to them for decision; nor do they even assert this to be the law by way of *obiter*, for what they say upon this subject is in commenting upon a quotation as to the English bankruptcy practice where that rule prevails. It will be observed that this decision, as well as that in Sohier *v.* Loring, 6 Cushing, 537, are in direct conflict with the Kansas cases relied upon by our opponents. We give here a quotation from the Wisconsin court, showing its views as to the weight of authority:

"The learned counsel for the appellant," who was contending for the partial payment rule, "admits that the distinction he suggests has been made by most of the courts in this country and in England, where some different rule has not been established by statute law, and that the great weight of authority is against the rule he contends for."

Then, after saying they must have very good reason to depart from a conclusion adhered to by so many courts, and citing a very large number of cases, some of which

will be found in this brief, and showing that the equitable principle, that marshalling is never applied so as to prejudice a creditor holding a double security, would be infringed if applied as asked, they say:

"It would seem to be imposing too great a task upon us to cite the multitude of cases in which the rule of the court below," which was affirmed, "has been acted upon, and vindicate their reason and logic by quotations from their decisions."

We have shown that the rule thus deduced from the language of the banking act, and enforced by the prior decisions of this Court, is in accord with the very decided preponderance of authority in cases involving similar questions. While the courts of Massachusetts, Maryland, Iowa, Kansas and Washington have held that the secured creditor can be compelled in the first instance to exhaust his security; and while the courts in Alabama, Colorado and Nebraska have contended that the fund should be distributed among the claims as they stand at the time of distribution, we have shown that this Court has rejected the latter view, and that to apply either of these views to the National Banking Act would not only involve a judicial amendment to that act, but would be counter to the law, as heretofore judicially proclaimed in New Hampshire, Connecticut, Rhode Island, New York, Pennsylvania, North Carolina, South Carolina, Tennessee, Kentucky, Ohio, Michigan, Wisconsin, Illinois and Oregon.

We therefore submit that the conclusion of the Court below as to the method of ascertaining the basis for dividends is supported both by reason and authority; and that its decree in that regard should be affirmed.

October, 1898.

William Worthington,
Geo. H. Yeaman,
Of Counsel for Appellee.